

BEFORE
THE PUBLIC SERVICE COMMISSION
OF SOUTH CAROLINA
DOCKET NO. 2004-297-S – ORDER NO. 2005-_____
MARCH 23, 2005

IN RE: Application of Midlands Utility)	
Inc. for adjustment of rates)	
and charges and modification of)	
certain terms and conditions for the)	
provision of water and sewer)	
services.)	
_____)	

**OFFICE OF REGULATORY
STAFF’S PROPOSED ORDER ON
APPLICATION OF RATES AND
CHARGES**

INTRODUCTION

This matter comes before the Public Service Commission of South Carolina (“the Commission”) on an application for increases in sewer rates and charges filed by Midlands Utility, Inc. (“Midlands”). Midlands’ application was accepted by the Commission pursuant to S.C. Code Ann. § 58-5-210 *et. seq.* and 26 S.C. Code Regs. 103-512. Midlands’ application was filed on October 6, 2004.

By correspondence, the Commission instructed Midlands to publish a prepared Notice of Filing, one time, in a newspaper of general circulation in the areas affected by Midlands’ application. The Notice of Filing indicated the nature of the application and advised all interested persons desiring to participate in the scheduled proceedings of the manner and time in which to file appropriate pleadings for inclusion in the proceedings. In the same correspondence, the Commission also instructed Midlands to notify each customer affected by the application by mailing each customer a copy of the Notice of

Filing. Midlands furnished the Commission with an Affidavit of Publication demonstrating that the Notice of Filing had been duly published and with a letter in which Midlands certified compliance with the instruction of the Commission to mail a copy of the Notice of Filing to all customers affected by the application. No Petitions to Intervene were filed.

The Office of Regulatory Staff made on site investigations of Midlands' facilities, audited Midlands' books and records, and gathered other detailed information concerning Midlands' operations. Prior to January 1, 2005, the Public Service Commission Staff also made on-site investigations.

On February 24, 2005 at 10:30 a.m., a public hearing concerning the matters asserted in Midlands' application was held in the Commission's hearing room located at Synergy Business Park, 101 Executive Center Drive – Saluda Building, Columbia, SC. The full Commission, with Chairman Randy Mitchell presiding, heard the matter of Midlands' application. Scott Elliott, Esquire and Charles Cook, Esquire represented Midlands Utilities, Inc. Florence Belser, General Counsel of ORS and Wendy Cartledge, Esquire represented the Office of Regulatory Staff. David Butler, Esquire served as legal counsel to the Commission.

Midlands presented the testimony of Keith G. Parnell, President and Operations Manager of Midlands, and C. Kenneth (Ken) Parnell, Vice-President of Midlands and President of HPG and Company. The Office of Regulatory Staff presented testimony of Willie J. Morgan, Program Manager for the Office of Regulatory Staff Water and Wastewater Department, Dawn Hipp, Project Specialist for the Office of Regulatory Staff

Water and Wastewater Department, and Roy Barnette, Office of Regulatory Staff Auditor.

BACKGROUND AND PROCEDURAL MATTERS

Midlands is a closely held corporation organized and existing under the laws of the State of South Carolina and is a public utility within the meaning of S.C. Code Ann. §58-5-10(3) (Supp 2004). Midlands currently furnishes sewer collection and sewer treatment service to approximately 3000 active residential and commercial customers in Richland, Lexington, Fairfield and Orangeburg Counties under the schedule of rates approved by the Commission in Order Number 97-517, Docket Number 96-160-S, dated June 17, 1997. By Commission Order Number 2002-138 in Docket No. 2001-380-S dated March 1, 2002, Midlands' approved schedule of rates includes a collection only residential sewer charge.

Midlands requested approval of a two step (or two phase) schedule of rates and charges for sewerage service provided to its residential and commercial customers in all areas served. The two step schedule of rates and charges would be implemented in two stages. Notice of Midlands' intention to file the new schedules was given more than the required thirty (30) days prior to this application. The first increase is required to raise rates to pay for new costs created by necessary construction of capital improvements. The second increase in rates will be required upon completion of construction.

Midlands and two other closely held corporations, namely Bush River Utilities, Inc. ("Bush River") and Development Services, Inc. ("DSI"), are all owned and operated by two brothers, Keith G. Parnell and C. Kenneth (Ken) Parnell, each owning equal shares of these three family owned corporations. The corporations are connected by

virtue of ownership, common purpose, staffing, and inter-company borrowings of assets and equipment. Each of the three corporations is a public utility within the meaning of S.C. Code Ann. §58-5-10(3) (Supp. 2004), and is therefore regulated by the Commission.

At the outset of the hearing, counsel for ORS and counsel for Midlands advised the Commission that the parties had reached an agreement with respect to certain issues in these matters. Scott Elliott, attorney for Midlands, advised the Commission that Midlands had already begun changing some of its business practices as a result of the recommendations of ORS. Mr. Elliott informed the Commission that Midlands has upgraded its billing form to reflect that the bill clearly states office hours, the phone number for emergency calls as well as routine calls and that Midlands has also submitted an updated authorized utility representative form. Mr. Elliott further stated that Midlands would follow the recommendations of ORS with respect to disconnect charges and interest rates to be charged on deposits and that Midlands desires to comply with the rules and regulations of the Commission.

Florence P. Belser, ORS General Counsel, advised the Commission that ORS does not contest the second phase of the increase going into effect provided that the Commission requires that ORS conduct an audit before the rates go into effect. ORS requested that the Commission provide clarification regarding the parameters of the audit.

Legal counsel further advised the Commission that the remaining issues to be resolved mainly involved accounting issues concerning expenses and depreciation.

FINDINGS OF FACT AND EVIDENCE SUPPORTING FINDINGS OF FACT

After thorough consideration of the entire record in the Midlands hearing, including the testimony and all exhibits, and the applicable law, the Commission makes the following findings of fact and conclusions of law with respect to Midlands:

1. Midlands is a closely held privately owned corporation furnishing sewer collection and sewer treatment service to 2,937 residential and commercial customers in Richland, Lexington, Fairfield, and Orangeburg Counties and is subject to the jurisdiction of the Commission pursuant to S. C. Code Ann Section 58-5-10 et seq.

The evidence supporting this finding is contained in the application filed by Midlands, in the testimony Midlands witnesses, Mr. Keith Parnell and Mr. Ken Parnell, and in prior Commission Orders in the docket files of the Commission, of which the Commission takes judicial notice. By filing its application, Midlands admits that it is a public utility within the meaning of S.C. Code Ann Section 58-5-10 and submits itself to the jurisdiction of the Commission.

2. The appropriate test year period for purposes of this proceeding is the twelve month period ending June 30, 2004.

Midlands chose to file its application on the twelve months ending June 30, 2004. Accordingly, Midlands picked the test year ending June 30, 2004. Based on Midlands' proposed test year, the ORS utilized the same test year period for its accounting and pro forma adjustments. A fundamental principle of the rate making process is the establishment of a historical test year with the basis for calculating a utility's operating margin and, consequently, the validity of the utility's requested rate increase. The test year is established to provide the basis for making the most accurate forecast of the utility's rate base, reserves, and expenses in the near future when the prescribed rates are

in effect. *Porter v. South Carolina Public Service Commission*, 328 S.C. 222, 493 S.E.2d 92 (1997), citing *Hamm v. S. C. Pub. Serv. Comm'n*, 309 S.C. 282, 422 S.E. 2d 110 (1992). While the Commission considers a utility's proposed rate increase based upon occurrences within the test year, the Commission will also consider adjustments for any known and measurable out-of-test year changes in expenses, revenues, and investments, and will also consider adjustments for any unusual situations which occurred in the test year. Where an unusual situation exists which shows that the test year figures are atypical, the Commission should adjust the test year data. See *Southern Bell v. The Public Service Commission*, 270 S.C. 590, 244 S.E. 2d 278 (1978); see also, *Parker v. South Carolina Public Service Commission*, 280 S.C. 310, 313 S.E.2d 290 (1984), citing *City of Pittsburgh v. Pennsylvania Public Utility Commission*, 1887 P.A. Super. 341, 144 A.2d 648 (1958); *Southern Bell v. The Public Service Commission*, 270 S.C. 590, 244 S.E.2d 278 (1978). Based on the information available to the Commission, the Commission is of the opinion, and, therefore, concludes that the test year ending June 30, 2004 is appropriate for the purposes of this rate request.

3. The Commission will use the operating margin as a guide in determining the lawfulness of Midlands' proposed rates and for the fixing of just and reasonable rates.

In its application, Midlands does not specify or propose a particular rate setting methodology. "The Public Service Commission has wide latitude to determine an appropriate rate-setting methodology." *Heater of Seabrook v. Public Service Commission of South Carolina*, 324 S.C. 56,64, 478 S.E.2d 826,830 (1996). ORS, in support of its position and recommendations in this case, presented in its exhibits and testimonies information regarding the operating margins for per books test year, test year

as adjusted, Phase-I of the proposed increase, adjustments for After Construction Operations, and computation of the After Construction Operation results after adjustments associated with the proposed construction and revenues. Hearing Exhibit 14, Audit Exhibit A and late filed Exhibit 15 - Corrected Audit Exhibit A-1. ORS also presented various alternative operating margins and associated revenue requirements for these operating margins. Hearing Exhibit 13, Exhibit DMH-9. Midlands' neither supplied any operating margin information in its application nor supplied sufficient information on which rates could be set using rate of return on rate base methodology. Because the only information available relates to operating margin methodology, the Commission finds that the operating margin is the appropriate rate-setting methodology to use in this case.

4. Midlands is seeking an increase in rates in two phases. By its Application, Midlands is seeking an increase in its rates and charges, net of uncollectibles, for sewer service pursuant to a two-phase approach which Midlands asserts results in additional monthly revenues to the monthly revenue generated during the test year ending June 30, 2004, of \$26,353 during Phase-I and \$29,282 during Phase-II. As will be demonstrated infra, we believe that a Phase-I increase in revenues of \$323,809, and an additional increase in revenues of \$35,200 in Phase-II is appropriate.

The evidence for this finding concerning the amount of the requested rate increase is contained in the Application (as amended) by Midlands. Midlands' Application (as amended), Exhibit 2, Pp. 1 through 7. The testimony and exhibits of ORS witnesses Dawn Hipp and Roy Barnette reveal that the level of total operating revenues under Phase-I of the rates are \$936,501, which reflects ORS' adjustments and a net authorized

increase in operating revenues of \$323,809. With respect to Phase 2, the testimony and exhibits of ORS witnesses Dawn Hipp and Roy Barnette show the level of total operating revenues after implementation of Phase II of the rates are \$971,701, which reflects ORS' adjustments and a net authorized increase in operating revenues of \$35,200.

5. The appropriate operating revenues of Midlands during the test year under present rates and after accounting and pro forma adjustments are \$612,692.

Midlands' Application shows per book test year total operating revenues of \$718,319. Midlands' Application (as amended), Exhibit 2, P. 1 of 7. ORS verified the per book balances to the books and records of Midlands. The book figures reflect that Operating Revenues for Midlands totaled \$956,500 including interest income of \$306. ORS proposes to adjust revenues to reflect test year customer billings in the amount of (\$335,652) and to remove interest earned on the CD in the amount of (\$306) from other income - interest. ORS also proposed to reclassify Tap Fees to Contributions in Aid of Construction.

The Commission adopts the proposed adjustments as outlined by ORS. Test year revenues calculated using customer billings provide a verifiable revenue amount for the test period. Further, tap fees are not revenue to the utility because tap fees are paid by the customer and are properly recorded as a rate base item in Contributions in Aid of Construction. We find the revenue adjustments proposed by ORS to be reasonable and adopt the ORS' revenue adjustments. The effect of the ORS adjustments annualizes the test year revenues and as stated by ORS witness Barnette were justified and therefore verified by his audit. Therefore, we find the appropriate total operating revenues for the test year after accounting and pro forma adjustments to be \$612,692.

6. The appropriate operating expenses for Midlands for the test year under present rates and after accounting and pro forma adjustments are \$604,044.¹

The parties offered certain adjustments affecting operating expenses for the test year. Midlands' witnesses, Mr. Keith Parnell and Mr. Ken Parnell, and ORS witnesses Mr. Willie Morgan, Ms. Dawn Hipp and Mr. Roy Barnette offered testimony and exhibits detailing adjustments proposed by the parties. See Hearing Exhibits 1, 2, 3, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, and Midlands' Application, as amended. This section addresses the adjustments to expenses.

(A) Officers' Salaries (ORS Adjustment #3)

(1) Position of Midlands: Midlands proposes to increase officers' salaries in the amount of \$19,808. Mr. Keith Parnell, in his Rebuttal Testimony states that the \$19,808 is intended as compensation for Ken Parnell who has put in substantial hours attending meetings, helping with loan matters, planning and engineering expertise. Mr. Keith Parnell contends that Mr. Ken Parnell has saved Midlands customers significant dollars through his participation and contribution to Midlands and that he should not be expected to donate his time. Prefiled Rebuttal Testimony of Keith G. Parnell, P.5, ll. 2-7, Hearing Exhibit 2.

(2) Position of ORS: ORS determined that no salary increases were given during the test year, and, therefore, no adjustment was necessary. Prefiled Direct Testimony of Barnette, P. 6 ll. 15; Hearing Exhibit 14, Corrected Audit Exhibit A-1.

(3) Decision of the Commission: According to witness Barnette, this adjustment does not reflect a known and measurable change. There was no increase in salary during the test year nor an increase in salary made outside the test year. Stating an intent to do

¹ ORS has included updated rate case expenses as submitted by Midlands in late-filed Hearing Exhibit 8.

something does not constitute a known and measurable change because in reality the action may never occur. Because the adjustment proposed by Midlands does not reflect a known and measurable out-of-test year change, we find that the adjustment cannot be accepted, and therefore, Midlands' proposed salary increase of officers' salary of \$19,808 is disallowed.

(B) Repairs - Non-Plant Maintenance (ORS Adjustment #4)

(1) Position of Midlands: Midlands proposes no adjustment.

(2) Position of ORS: ORS proposes to reduce repairs and non-plant maintenance expenses for personal travel and miscellaneous expenses in the amount of \$1,085 of Mr. Charles Parnell paid for by Midlands.

(3) Decision of Commission: Mr. Charles Parnell is the former owner of Midlands but is no longer employed by Midlands. Payment of personal travel expenses or other expenses of Mr. Charles Parnell is not payment of utility expenses incurred in providing utility services. Because ORS did not find justification for this adjustment and these repairs and expenses are unrelated to the utility operations of Midlands, these amounts are not allowed. Therefore, ORS' adjustment is adopted.

(C) Expenses for Repairs (ORS Adjustment #5)

(1) Position of Midlands: Mr. Keith Parnell contends that the \$16,692 should remain in the expense category since Midlands' operating history reflects at least that amount or more annually in breakage to plant and equipment. Rebuttal Testimony of Keith G. Parnell, P. 5, ll. 8-13, Hearing Exhibit No. 2.

(2) Position of ORS: ORS proposes to reduce operational and management expenses - plant maintenance and reclassify several items to plant. ORS determined these

expenses were in fact capital expenditures because the items had a service life of more than one year. These items total \$16,692 and include such items as pipe, computers, motors, drives, and casing. See, Hearing Exhibit 14, Exhibit A-2. ORS determined that Midlands' proposal to increase this expense by \$228 was an estimate.

(3) Decision of Commission: The Commission did not find Midlands' adjustment to be a known and measurable cost since it is an estimate. The Commission adopts ORS reclassification of items to plant and equipment for capitalization purposes. As the items reclassified by ORS have a service life of more than one year, these items are properly capitalized rather than expensed.

(D) Chemical Expense (ORS Adjustment #6)

(1) Position of Midlands: Midlands has listed \$639 for chemical expense.

(2) Position of ORS: ORS proposes no adjustment to operational and maintenance expense for chemicals. ORS determined that Midlands' proposal to decrease chemical expense by \$639 is due to rounding.

(3) Position of Commission: Because no justification was provided by Midlands as to the necessity of this adjustment, we find that no adjustment is appropriate and adopt ORS' position on this issue.

(E) Auto/Truck/Other expense (ORS Adjustment #7)

(1) Position of Midlands: Midlands did not adjust expenses for this item.

(2) Position of ORS: ORS proposes to reduce operational and maintenance expense in the amount of \$825 for personal charges to Mr. Charles Parnell's American Express card which were paid by Midlands.

(3) Position of Commission: We find no justification for personal charges of Mr. Charles Parnell being paid by Midlands. These charges have not been shown to be necessary utility expenses for the provision of utility services; therefore, we find ORS' adjustment to be appropriate, and we adopt ORS' adjustment. Operational and maintenance expense will be reduced in the amount of \$825 for personal charges to Mr. Charles Parnell's American Express card which were paid by Midlands.

(F) Vehicle Expense (ORS Adjustment #8)

(1) Position of Midlands: Midlands proposes an adjustment of \$1,695 for insurance premiums.

(2) Position of ORS: ORS proposes to increase operational and maintenance expense - vehicle expense to record Midlands' proportional share of insurance premiums paid by Bush River Utilities, Inc. ("BRUI"). BRUI paid insurance premiums related to vehicles in the amount of \$3,926 during its test year ending December 31, 2003. Of that amount \$808 was determined to be for insurance coverage on personal vehicles and, therefore, not allowable. The balance of the insurance premiums \$3,118 was allocated to Midlands and BRUI based on single family equivalents. Single family equivalents were 2,937 (69.09%) for Midlands and 1,314 (30.91%) for BRUI. Therefore, Midlands would be charged 69.09% or \$2,154 and BRUI charged 30.91% or \$964. Midlands proposed an adjustment of \$1,695, which ORS determined to be an estimate. Prefiled Testimony of Barnette, P. 7, ll.8-17, Hearing Exhibit No. 14, Corrected Audit Exhibit A-1.

(3) Decision of Commission: Midlands' proposed adjustment is not known and measurable. We find that ORS adjustments are appropriate as ORS disallowed expenses

not related to utility operations and provided a reasonable and measurable calculation for allocating an expense shared by two of the three companies owned by the Parnells.

(G) Truck Expense (ORS Adjustment #9)

(1) Position of Midlands: Midlands proposed no adjustment.

(2) Position of ORS: ORS proposed to adjust operational and maintenance expense - vehicle expense to allocate truck expenses to reflect 1/3 of the expense to Midlands. Midlands stated it used the Ford F-250 owned by Developmental Services, Inc. ("DSI") 1/3 of the time. Total truck expenses as reflected on the DSI books amount to \$1,109 which is comprised of \$858 for vehicle insurance and \$251 for vehicle repairs. One third (1/3) of \$1,109 is \$370; therefore, to allow one-third (1/3) of the truck expense, ORS' adjustment is \$370.

(3) Decision of Commission: Midlands did not contest this adjustment. We find that the adjustments are reasonable and adopt them. Thus, the amount of one-third (1/3) of the truck expense, or \$370, shall be allocated to Midlands.

(H) Taxes Other Than Income (ORS Adjustment #10)

(1) Position of Midlands: Midlands proposed no adjustment.

(2) Position of ORS: ORS proposes to adjust Taxes Other Than Income for one-third (1/3) of the total vehicle taxes paid by DSI on the Ford F-250. Midlands states that it used the truck one-third (1/3) of the time. The total taxes as booked by DSI were \$328, and, therefore, an adjustment of \$109 was required to allocate one-third (1/3) of that expense to Midlands.

(3) Decision of Commission: We find that the adjustment of ORS is appropriate, and we adopt this adjustment.

(I) Utilities Expense (ORS Adjustment #11)

(1) Position of Midlands: Midlands proposed a reduction to utilities expense in the amount of \$963.

(2) Position of ORS: ORS does not propose an adjustment to the utilities expense account, and ORS determined Midlands proposed reduction of \$963 was an estimate.

(3) Decision of Commission: Midlands' proposed adjustment is not known and measurable. Because the adjustment cannot be verified, Midlands' proposed reduction to utilities expense is not allowed.

(J) Insurance Expense (ORS Adjustment #12)

(1) Position of Midlands: Midlands did not propose an adjustment.

(2) Position of ORS: ORS proposes to allocate to Midlands a portion of insurance costs paid by BRUI for general liability and umbrella coverage on commercial property. BRUI paid premiums totaling \$1,180. ORS allocated this balance among the three (3) affiliated companies based on the percentage of single family equivalents. Single family equivalents (SFEs) were 2,937 (54.09%) for Midlands; 1,314 (24.20%) for BRUI; and 1,179 (21.71%) for DSI. ORS allocated \$638 [the product of the total premiums of \$1,180 multiplied by 54.09% which reflects Midlands' proportion of total SFEs served by the three companies] to Midlands. Prefiled Testimony of Barnette, P. 8, ll. 10-16. Hearing Exhibit 14, Audit Exhibit A-2.

(3) Decision of Commission: Midlands did not contest the adjustment of ORS. The Commission finds ORS' proposed adjustment is reasonable, and we adopt this adjustment. Insurance expense shall be allocated to Midlands in the amount of \$638.

(K) Insurance Premiums (ORS Adjustment #14)

(1) Position of Midlands: Midlands proposes to increase insurance expenses by \$8,705.

(2) Position of ORS: ORS determined Midlands' proposal to be an estimate. ORS proposes to reduce O&M expenses for insurance costs for General Liability and Umbrella premiums paid by Midlands for the benefit of BRUI and DSI. During the test year, Midlands made various payments to Auto Owners Insurance Companies for these coverages totaling \$3,646. ORS proposes to allocate these premiums to the three affiliated companies based upon single family equivalents, i.e., Midlands \$2,937 (54.09%); BRUI \$1,314 (24.20%); and DSI \$1,179 (21.79%). Therefore, ORS proposes to allocate to BRUI \$3,646 multiplied by 24.20% or \$882 and to DSI \$3,646 multiplied by 21.79% or \$792 for a total allocation adjustment of (\$1,674). ORS Witness Barnette, Direct Testimony, P. 9, ll. 6-14 and Exhibit 15, Corrected Audit Exhibit A-1.

(3) Decision of Commission: The Commission has found ORS' adjustments and manner in arriving at these adjustments to be reasonable and verifiable. The ratepayers of Midlands should not be charged for expenses incurred by the other utilities. The Commission allows the ORS recommended adjustments to reduce Midlands' general liability and umbrella insurance by \$1,674.

(L) Treatment Costs (ORS Adjustment #15)

(1) Position of Midlands: Midlands proposes to increase O&M expenses for treatment in the amount of \$110,979.

(2) Position of ORS: ORS proposes to remove treatment costs of \$265,021 as this is a pass through expense for collection only customers. The collection only

customers will be charged back for their proportionate share of treatment cost when the bill is received by Midlands from the treatment provider. Therefore, in establishing a collection only rate, ORS proposes that these treatment costs be removed. ORS Witness Barnette, Direct Testimony, P. 9, ll. 15-21, and Hearing Exhibit 15, Corrected Audit Exhibit A-1.

(3) Position of Commission: The Commission adopts the adjustment made by ORS to remove treatment costs of \$265,021 as reasonable and verifiable for regulatory purposes. These treatment costs are a pass through expense for collection only customers who will be charged back for their proportional share of treatment costs when Midlands receives the bill from the treatment provider.

(M) Service Contracts (ORS Adjustment #16)

(1) Position of Midlands: Midlands proposes to increase O&M expenses in the amount of \$27,120 as a payable due to DSI. Midlands' rationale is that Midlands operate and maintains two pieces of equipment that are owned by DSI. The two pieces of equipment are a backhoe and a generator that are necessary for Midlands' operation of the sewer system. Midlands operates DSI's 420D backhoe 95% of the time and operates DSI's XQ125 generator 100% of the time. Midlands' position is that the weekly, monthly or annual rental from any commercial company leasing this equipment would more than exceed the agreed upon value established between Midlands and DSI. Mr. Parnell provided a quote for a monthly rental of DSI's backhoe of \$1,500 a month and a monthly rental of DSI's generator of \$2,625 per month. Midlands' position is also that DSI purchased the equipment which benefited Midlands' customers and DSI received a tax credit worth approximately \$100,000 to revenue. Midlands also presented a rental

agreement dated February 23, 2005 concerning Midlands' rental of the equipment. Midlands Witness Keith G. Parnell, Hearing Exhibit 2, Rebuttal Testimony, Pp. 5 – 6; Hearing Exhibit 3.

(2) Position of ORS: ORS found no actual payments during the test year and no Account Payable on the books and records of Midlands and disallowed the proposed adjustment. During the DSI rate case, DSI proposed to increase its revenues to account for rental “payments” by Midlands for use of this equipment. DSI proposed to charge Midlands \$27,120 for the use of DSI's equipment. No contract was issued, and ORS determined the adjustment to be unallowable. The Commission in Docket No. 2004-212-S, Order No. 2005-42 dated February 2, 2005, agreed with ORS in its determination. ORS Witness Barnette, Hearing Exhibit 14, Direct Testimony, P. 10, ll. 1-7 and Surrebuttal Testimony, P. 3, ll. 7-14.

(3) Decision of Commission: Midlands witness Keith G. Parnell testified at the hearing that Midlands did not pay DSI the “contract” payment \$27,120 for the use of the equipment in the test year or after the test year and that no documentation was available concerning the rental during the test year. Cross examination of Witness Keith G. Parnell, Hearing Transcript, Pp. 65-66. Additionally, the contract offered by Midlands was dated on February 23, 2005, which was the day before the hearing in this case. This contract was not available to the ORS during its audit and, in fact, was not executed until approximately eight months after the end of the test year. It appears that the contract was prepared solely to obtain recovery of alleged expenses which have not been paid or even booked as an Account Payable. Because Midlands did not pay the expense to DSI, did not book the expense as an Account Payable, and did not have a contract for the expense

until the eve of this hearing, we find no realistic justification of an actual expense. Therefore, the Commission agrees with the position of ORS and disallows Midlands' proposed adjustment.

(N) Salaries Other (ORS Adjustment #17)

(1) Position of Midlands: Midlands proposes an adjustment of \$3,450 for increase in salaries.

(2) Position of ORS: ORS determined that one employee received a salary increase during the latter part of the test year. ORS proposes to adjust for the increase. Total annualized wages were calculated to be \$216,298 with total booked wages of \$211,742 resulting in an adjustment of \$4,556. ORS Witness Barnette, Hearing Exhibit 14, Direct Testimony, P.10, ll. 8-12 and Hearing Exhibit 15, Corrected Audit Exhibit A-1.

(3) Decision of Commission: The adjustment of ORS is verified and reflects a known and measurable change. The Commission adopts the adjustment of ORS.

(O) Professional Fees for Legal and Consulting (ORS Adjustment #18)

(1) Position of Midlands: On Midlands' books, three accounts, Attorney Fees (\$102,877), Legal Fees (\$37,226), and Consulting Fees (\$37,226) total \$163,463 and represent professional fees.

(2) Position of ORS: ORS proposes to adjust these amounts. Although some of these amounts were paid during the test year, a portion of these fees were for services provided to Midlands in previous years or were determined to be non-allowable for rate making purposes. Most of these invoices were billed by Austin, Lewis and Rogers, P.A. and pertained to the 208 Plan Amendments or for services outside the test year dealing

with litigation involving Midlands vs. City of Cayce. Following ORS' review of these accounts, it was determined that \$47,464 was unallowable as lobbying expenses or was paid for services outside the test year. ORS Witness Barnette, Hearing Exhibit 14, Direct Testimony, P. 10, ll. 13-22 and Hearing Exhibit 15, Corrected Audit Exhibit A-1. ORS Witness Barnette testified that the \$47,646 that was disallowed by ORS was comprised of \$19,415 for lobbying, which ORS does not consider to be an allowable expense in ratemaking, \$666 related to the filing of the loan documents, an expense that should be capitalized and depreciated over the useful life of the asset, and \$27,383 in payments for services received outside the test year. ORS Witness Barnette, Hearing Exhibit 14, Surrebuttal Testimony, P. 3, ll. 17 -23.

(3) Decision of Commission: The Commission finds ORS' adjustments to be of sound regulatory policy and also to be known and measurable. We find that lobbying expenses are not an item upon which rates should be based. Further, the costs associated with the filing of the loan documents are expenses of the loan which should be capitalized with other costs of the loan. We therefore accept ORS' adjustment and find that \$47,464 of the legal, consulting, and attorneys fees should be disallowed.

(P) Other Operation Expenses (ORS Adjustment #19)

(1) Position of Midlands: Midlands proposed to increase Other Operating Expenses by \$1,612.

(2) Position of ORS: ORS determined that \$272 travel charges for personal travel expenses unrelated to company business on Mr. Charles Parnell's American Express were paid by Midlands. ORS reduced G & A by \$272. ORS determined that Midlands' proposed increase of \$1,612 was an estimate. ORS Witness Barnette, Hearing

Exhibit 14, Direct Testimony, P, 11, ll. 1-5 and Hearing Exhibit 15, Corrected Audit Exhibit A-1.

(3) Decision of Commission: Midlands' adjustment is not known and measurable. Further, the personal travel expenses unrelated to utility operations are not recoverable because those expenses were not incurred in the provision of utility services. Therefore, the Commission accepts ORS' adjustment.

(Q) Telephone and Office Expense (ORS Adjustment #20)

(1) Position of Midlands: Midlands proposes to increase this account by \$449.

(2) Position of ORS: ORS proposes to reduce telephone and office expense in the amount of \$181. ORS proposes to remove a \$50 cash contribution made to Dunn's Chapel Church and \$131 of telephone bills paid by Midlands for BRUI. ORS determined Midlands' proposed increase to be due to rounding. ORS Witness Barnette, Hearing Exhibit 14, Direct Testimony, P. 11, ll. 6-9 and Hearing Exhibit 15, Corrected Audit Exhibit A-1.

(3) Decision of Commission: ORS Witness Barnette testified that this adjustment appears to be due to rounding. Because the adjustment cannot be verified, Midlands' adjustment cannot be accepted. The Commission approves the adjustment of ORS to reduce telephone and office expense in the amount of \$181 to remove a charitable contribution and an expense related to another utility.

(R) DHEC Fines (ORS Adjustment #21)

(1) Position of Midlands: Midlands proposes to increase DHEC fines by \$9,549.

(2) Position of ORS: ORS proposes to eliminate DHEC fines of \$30,451, as they are not considered a normal business expense. ORS Witness Barnette, Hearing Exhibit

14, Direct Testimony, P. 11, ll. 10-12, and Hearing Exhibit 15, Corrected Audit Exhibit A-1.

(3) Decision of Commission: The Commission adopts the adjustment of ORS. Customers should not be required to absorb the cost of DHEC fines as these fines are not a normal business expense. The utility is required to operate in compliance with the law. Rate payers should not pay for violations of the utility in rates.

(S) Administrative Expenses (ORS Adjustment #22)

(1) Position of Midlands: Midlands did not have an adjustment for administrative expenses.

(2) Position of ORS: ORS proposes to reduce Administrative expenses by \$3,254. ORS verified the booked expenses related to Administrative expenses. During the performance of the audit of BRUI, ORS determined the Administrative expenses of both BRUI and Midlands are paid by Midlands. ORS compiled those expenses that make up this category of expense from the books and records of Midlands. Since Midlands has a fiscal year ending June 30th, ORS took a two-year average of all expenses in the category in an effort to estimate the appropriate allocation of Administrative expenses on the books of BRUI. ORS' calculation indicated that the expenses to be allocated totaled \$88,173. The average expenses were then allocated to each company based upon single family equivalents, with Midlands bearing 69.09% of the expense and BRUI bearing 30.91% of the expenses. ORS recommends that an additional \$3,254 in Administrative expense be allocated to BRUI, with a corresponding reduction to the books of Midlands of (\$3,254). ORS Witness Barnette, Hearing Exhibit 14, Direct Testimony, P. 11, ll. 13-22 and P. 12, ll. 1-2 and Hearing Exhibit 15, Corrected Audit Exhibit A-1.

(3) Decision of the Commission: The Commission finds ORS' adjustments and the manner in arriving at these adjustments to be reasonable and verifiable. The Commission will allow these expenses to be allocated to Midlands and BRUI. The Commission also finds ORS' allocation based on single family equivalents reasonable and appropriate for regulatory purposes and approves ORS' recommended adjustments to reduce Midlands' Administrative expenses by \$3,254.

(T) Loan Costs (ORS Adjustment #23)

(1) Position of Midlands: Midlands proposes to amortize loan costs of \$81,591. Midlands proposes to amortize Midlands' proportionate share of these loan costs at the rate of \$1,500 per year over a twenty (20) year period.

(2) Position of ORS: ORS disallows this adjustment and proposes that all loan costs be capitalized and no amortization be recognized. By capitalizing these costs, Midlands will recover the loan costs through depreciation expense over the useful life of the asset to be constructed with the loan proceeds. ORS Witness Barnette, Hearing Exhibit 14, Direct Testimony, P. 12, ll. 3-8 and Hearing Exhibit 15, Corrected Audit Exhibit A-1.

(3) Decision of Commission: The Commission concurs with the adjustment of ORS, and all loan costs will be capitalized by Midlands.

(U) Amortization of Two and one-half months of Loan Cost (ORS Adjustment #24)

(1) Position of Midlands: Midlands proposes to amortize two and one-half (2 ½) months of total loan costs, or \$680, based on a useful life of twenty five years.

(2) Position of ORS: ORS proposes to capitalize loan costs and depreciate the costs over the useful life of the asset. Since the asset has yet to be placed in service, ORS disallows this adjustment. This amount was included in Other Operating Expenses of the Midlands' books. ORS Witness Barnette, Hearing Exhibit 14, Direct Testimony, P. 12, ll. 9-12 and Hearing Exhibit 15, Corrected Audit Exhibit A-1.

(3) Decision of Commission: The Commission concurs with the recommendation of ORS. Since the asset has yet to be placed in service, the Commission disallows Midlands' proposal to amortize two and one-half (2 ½) months of total loan costs.

(V) Rate Case Expenses (ORS Adjustment #25)

(1) Position of Midlands: Midlands proposes to adjust G&A expense for rate case expenses associated with its filing. In its application, originally Midlands proposes \$20,000 in rate case expenses over a three year period. Midlands presented testimony that three years is the standard amortization period used for rate case expenses that has been approved by the Commission in the past. Midlands filed a late filed exhibit adjusting attorneys fees and costs for the rate case. See Hearing Exhibit 8. As a result, the total attorneys fees and costs is \$41,676.

(2) Position of ORS: ORS proposes to amortize total rate case expenses of \$27,736 over a five (5) year period for a total adjustment of \$8,335. ORS' adjustment is comprised of \$1,000 for expenses for accounting services incurred after the test year, \$39,590 for incurred legal expenses and newspaper advertisements in *The Times and Democrat* of \$104 and *The State* of \$982, for total rate case expenses of \$41,676. ORS examined the time between rate cases as one measure for an amortization period.

Midlands' previous rate case proceedings were in 1991 and 1997 resulting in an average of approximately seven (7) years between rate cases. ORS determined a seven (7) year amortization period is too long; therefore, ORS proposes to use a more reasonable amortization period of five (5) years for recovery of rate case expenses. ORS Witness Barnette, Hearing Exhibit 14, Direct Testimony, P. 12, ll. 13-22 and P. 13, ll. 1-2 and Hearing Exhibit 15, Corrected Audit Exhibit A-1.

(3) Decision of Commission: The Commission concludes that the ORS adjustments for rate case expenses are appropriate for the purposes of this Order. The ORS adjustment is based on expenses incurred during the test year and billing invoices detailing legal fees charged as of the hearing date. The Commission adopts a five-year amortization period as a reasonable period for Midlands to recover these expenses without causing undue hardship on ratepayers. Midlands' position that three years is the standard amortization period used for rate case expenses that has been approved by the Commission in the past is not sufficient legal justification for use of a three year amortization period. The Commission cannot make an adjustment based merely on past Commission practice. *Hamm v. South Carolina Public Service Comm'n*, 309 S.C. 282, 422 S.E.2d 110 (1992). On the other hand, another jurisdiction has recognized that an appropriate amortization period is the time incurred between rate cases. In *Mississippi Public Service Commission v. Coast Waterworks, Inc.*, 437 So.2d 448 (1983), the Supreme Court of Mississippi stated

since utilities normally do not apply for an increase each year, the total cost for preparing the rate case should not be allowed in the test year. Instead, the cost should be amortized over a number of years reasonably representing the period, as shown by experience, between applications for a rate increase.

While no one can accurately predict when the utility will present another case for a rate increase, the Commission has approved both Phase-1 and Phase-2 of the requested rates. The Commission will therefore allow \$41,676 in rate case expenses to be recovered over a five year period for an adjustment of \$8,335. ORS' adjustment is more reasonable in that it was tied to the length between Midlands' previous rate cases. In addition, because we are approving both phases of Midlands' requested increase and the second phase will not be implemented until construction of the upgrades to the facilities is completed, we find that ORS' amortization period of five years is more reasonable than Midlands' proposed amortization period of three years.

(W) Payroll Taxes [Adjustment #27]

(1) Position of Midlands: Midlands does not propose an adjustment.

(2) Position of ORS: ORS proposes to adjust Taxes Other Than Income – Payroll taxes to reflect the change in taxes resulting from the annualized wages adjustment. Payroll taxes based upon annualized wages totaled \$16,547 (\$216,297 times 7.65%). Payroll taxes booked for the test year were \$14,555. Therefore, the payroll tax adjustment is (\$16,547-\$14,555) or \$1,992. Direct Testimony of Barnette – P. 13, ll. 11-15.

(3) Decision of Commission: The Commission finds ORS' adjustments of \$1,992 reasonable and adopts this adjustment.

(X) License and Fees [Adjustment # 28]

(1) Position of Midlands: Midlands does not propose an adjustment for license and fees.

(2) Position of ORS: ORS proposes to adjust Taxes Other Than Income – License and Fees for two items totaling \$575 determined to be non-allowable, i.e. SC Jobs –

Economic Development Authority – application fee of \$500 to apply for JEDA Bond and Mr. Charles Parnell’s annual membership fee to American Express of \$75.

(3) Decision of Commission: The Commission finds no testimony or evidence to show that these expenses are necessary in the provision of utility services. The application fee for JEDA Bond (\$500) and Mr. Charles Parnell’s annual American Express membership fee are, therefore, disallowed.

(Y) Interest Expense for Service Charges [Adjustment #29]

(1) Position of Midlands: Midlands has listed the service charges from Ben Satcher (\$43) and P&S Construction as Interest Expense.

(2) Position of ORS: ORS proposes to credit Interest Expense for service charges paid to Ben Satcher Motors (\$43) and P&S Const (\$8), a total of (\$51), and charge them to O&M Expenses – Truck Expense and Repairs.

(3) Decision of Commission: The Commission finds that the service charges in the amount of \$51 should be reclassified from Interest Expense to O & M Expense. The identified expenses are not properly included in Interest Expense. The Commission finds ORS’ adjustments and manner in arriving at these adjustments to be known and measurable.

(Z) Reclassification of Truck Expenses and Repairs [Adjustment # 30]

(1) Position of Midlands: Midlands did not propose an adjustment.

(2) Position of ORS: ORS proposes to charge O&M Expense – Truck Expense and Repairs for service charges paid to Ben Satcher Motors (\$43) and P&S Const (\$8), a total of \$51 and credit Interest Expense. This adjustment is a result of reclassification of expenses removed from Interest Expense.

(3) Decision of Commission: The Commission adopts the ORS position to reclassify service charges from Ben Satcher (\$43) and P&S Construction (\$8) from interest expense to O&M expense and repairs.

(AA) BB&T Interest Expense [Adjustment #31]

(1) Position of Midlands: Midlands proposes to allow \$885 associated with loan costs from the BB&T Loan as interest expense.

(2) Position of ORS: ORS proposes to remove, as unallowable, interest expense of (\$885) paid to BB&T associated with Loan Costs, since ORS determined that all loan costs should be capitalized and depreciated over the useful life of the asset.

(3) Decision of Commission: The Commission finds ORS' proposal to be in accordance with regulatory accounting principles and recognizes these costs should be capitalized and depreciated over the useful life of the asset. The Commission disallows Midlands' proposal to classify the \$885 associated with loan costs as an interest expense.

(BB) Lexington County Property Taxes [Adjustment #32]

(1) Position of Midlands: Midlands proposes no adjustment to Lexington County Property Taxes.

(2) Position of ORS: ORS proposes to allocate to BRUI and DSI their proportionate share of Lexington County property taxes. During the test year, Midlands paid a total of \$5,190 in property taxes to Lexington County, consisting of property taxes of \$2,354 on the corporate office building and \$2,836 on four (4) trucks and two (2) trailers. ORS proposes to allocate the taxes on the corporate office building based on single family equivalents with 24.20% or \$570 allocated to BRUI and 21.71% or \$511 allocated to DSI. The remainder of the property taxes on the corporate office or 54.09% equaling \$1,273 will

remain as a Midlands expense. Midlands proposes to allocate the property taxes on the four (4) trucks and two (2) trailers of \$2,836 based on various usage factors provided by Midlands with the majority of the expense remaining with Midlands. Based on the factors provide by the company, \$211 was allocated to BRUI and \$211 to DSI. The remainder of the property taxes on the trucks and trailers, or \$2,414 will remain as a MUI expense. Therefore, the total allocation to BRUI is \$781 and DSI is \$722 for a total reduction to Midlands' expenses of \$1,503.

(3) Decision of Commission: We find ORS' adjustments to be appropriate and adopt them as computed. ORS' proposed allocation requires each of the three utilities to bear its proportionate share. Accordingly, the property taxes on Midlands' books shall be reduced by \$1,503 to reflect BRUI's and DSI's share of the Lexington County property taxes.

(CC) Interest Expense on Customer Deposits [Adjustment #33]

(1) Position of Midlands: Midlands proposes an adjustment to interest expense of \$32,756.

(2) Position of ORS: ORS proposes to adjust Interest Expense to reflect the correct expense for interest on customer deposits. In Docket No.1996-013-A, Order No. 2003-593 dated October 3, 2003, the Commission approved a reduction in rates on customer deposits from 8%, which was approved by Order No. 93-12, to 3.5%. ORS calculated the adjustment based on Customer Deposits on the books at June 30, 2004 of \$58,600 multiplied by 3.5% which equals \$2,051. Midlands previously had interest recorded on the books of \$1,813; therefore, the interest adjustment is \$2,051 less \$1,813 or \$238. It should be noted, however, that since this calculation is made on a going forward basis, interest will

still be due and payable at 8% to those customers who had deposits with MUI prior to December 31, 2003. According to the books and records of Midlands, the Customer Deposits account had a balance of \$56,586 as of December 31, 2003.

(3) Decision of Commission: The Commission approves the adjustment of ORS to adjust interest expense in the amount of \$238 to reflect the proper expense as of the end of the test year. The Commission finds ORS' adjustments to be known and measurable.

(DD) Plant Depreciation expense [Adjustment # 34]

(1) Position of Midlands: Midlands proposes to decrease depreciation in the amount of \$293 which ORS determined to be an estimate.

(2) Position of ORS: ORS proposes to increase depreciation expense for plant in service by \$7,025. This adjustment results from several factors, and the calculation of the total is illustrated in Audit Exhibit A-2. See Hearing Exhibit 14. First, ORS proposes to adjust depreciation expenses using service life periods recommended by the Water/Wastewater Department. The Water/Wastewater Department proposes basing depreciation rates based on Florida Public Service Commission Water and Wastewater System Regulatory Law as recommended by NARUC. Accordingly, ORS recommends that the plant be depreciated over 32 years. Next, ORS proposes to allocate certain plant purchased by DSI that is also used by Midlands and BRUI. ORS also reduced the computed depreciation expense for the depreciation expense associated with tap fees. Tap fees are Contributions in Aid of Construction ("CIAC") and should be used to reduce rate base, rather than be included in revenue. ORS' adjustment removes depreciation expense on the plant paid for by CIAC.

(3) Decision of Commission: Midlands, to support its request for a twenty-five-year service life, offered testimony and three exhibits filed as a composite exhibit. Parnell Rebuttal Testimony and Hearing Exhibit 7, Exhibit 4. Of the composite exhibit, the first exhibit was an excerpt from a publication entitled The Design of Municipal Wastewater Treatment Plants, Volume I, pages 24, 69, 137, 141. However, the Commission finds this exhibit does not relate to the service life of the system upgrade proposed by Midlands. Rather, it provides generalities that should be considered when constructing a wastewater treatment facility.

Midlands also offers two letters from Mr. Jim Stanton from Interstate Utility Sales and Mr. Anthony R. Combs from Combs & Associates, Inc. Mr. Stanton states in his letter that “while the steel or concrete structure may last longer than twenty years if properly maintained, the internals of a plant will require replacement before twenty years.” Further, Mr. Stanton clearly states that certain portions of the facility, such as the structure, may last longer than twenty years. Considering the wastewater treatment facility is a combination of several different components, it is unclear from Mr. Stanton’s letter whether the average service life of the facility should be twenty years or not. Again, the Commission finds this exhibit discusses construction of wastewater treatment facilities in general and does not relate specifically to the upgrades proposed at Midlands. Further, as the letter only discusses certain components of the upgrade and not the average service life, the Commission does not consider this exhibit as authoritative.

The letter from Mr. Combs states that he “represent[s] the wastewater treatment plant equipment that [Mr. Parnell has] drawn and specified for the Bush River Wastewater Treatment Plant... [and] that a twenty year design life is our industry

standard for this equipment.” The Commission finds Mr. Combs letter speaks only to the equipment installed in the facility and does not reference the facility’s structure or the facility as a whole. Therefore, the Commission does not rely upon this exhibit in determining the appropriate service life of the wastewater treatment facility.

NARUC’s recommendation to follow the Florida Public Service Commission Water and Wastewater System Regulatory Law for service life is respected by this Commission, and will be adopted for this proceeding. Accordingly, we find that ORS’ adjustments are appropriate and adopt them as computed.

(EE) Mary Parnell’s Salary [Adjustment # 35]

(1) Position of Midlands: Midlands’ position is that the salary paid to Mary Parnell in the amount of \$9,360 is a general and administrative expense.

(2) Position of ORS: ORS proposes to remove from G&A Expense – Salaries – Other, the salary paid to Mary Parnell during the test year of \$9,360. Mrs. Parnell has no official job position with MUI.

(3) Decision of Commission: Midlands’ position does not reflect a known and measurable amount. Mrs. Parnell was not and is not an employee of Midlands. ORS’ adjustment is appropriate, and the Commission adopts this adjustment. Mrs. Parnell’s salary shall be removed from G&A expenses.

(FF) Payroll Taxes for Mary Parnell’s Salary [Adjustment #36]

(1) Position of Midlands: Midlands proposes to pay FICA and Medicare taxes on Mary Parnell’s salary.

(2) Position of ORS: ORS proposes to reduce Taxes Other Than Income – for the payroll taxes associated with Mrs. Mary Parnell’s salary of \$9,360. ORS calculated its adjustment: \$9,360 multiplied by 7.65% for FICA and Medicare taxes equals \$716.

(3) Decision of Commission: The Commission adopts the ORS proposed decrease to reduce taxes other than income by \$716. Midlands has provided no justification for Mary Parnell receiving a salary from Midlands.

(GG) Gross Receipts Taxes [Adjustment – #37]

(1) Position of Midlands: Midlands did not propose an adjustment to the as adjusted revenues Gross Receipts Taxes.

(2) Position of ORS: ORS proposes to reflect the gross receipts taxes associated with the as adjusted revenue. The gross receipts factor includes cost for administration, the Public Service Commission and the Office of Regulatory Staff. The ORS adjustment is computed using the as adjusted revenue of \$612,692 multiplied by the gross receipts factor of 0.007733226 resulting in an amount of \$4,738 less the per book amount of \$6,564, for a net adjustment of (\$1,826).

(3) Decision of Commission: The Commission adopts the adjustment made by ORS as reasonable and verifiable for regulatory purposes. Since the Commission has adopted and approved the ORS adjusted revenues, it is appropriate to apply the most recent gross receipts factor for an adjustment of \$1,826 to Midlands’ Gross Receipts Tax Expense.

(HH) Uncollectibles associated with the as Adjusted Revenue [Adjustment #38]

(1) Position of Midlands: Midlands does not propose an adjustment to uncollectibles for the as adjusted Revenue.

(2) Position of ORS: ORS proposes to adjust G&A expenses for a 1.5% allowance for uncollectibles associated with the as adjusted service revenues. The 1.5% allowance is an industry standard and is more than Midlands' actual test year uncollectible rate of 1.35%. ORS' adjustment used the As Adjusted Service Revenues of \$583,389 multiplied by the 1.5% allowance factor, for a total adjustment of \$8,751. See ORS Witness Barnette Testimony, P. 16, ll. 14-18.

(3) Decision of Commission: The Commission finds that the 1.5% uncollectible rate proposed by ORS and recognized as the industry standard to be reasonable. The 1.5% factor requires an adjustment of \$8,751 for the test year adjustment.

7. The operating margin for the test year under present rates and after accounting and pro forma adjustments approved herein is 1.43%.

The calculation for the operating margin was based on using the test year adjusted operating revenues of \$612,692 as approved herein and test year as adjusted operating expenses of \$604,044 as approved herein. Customer growth in the test year totaled \$117. Adjusted test year operations result in a "Net Income for Return" of \$8,765. Using the adjusted Net Income for Return less Interest Expense divided by operating revenues, we calculate an operating margin of 1.43%.

Per book total operating expenses amounted to \$954,840 including treatment expense of \$265,021 plus \$28,500 in items classified on the books as other income items but offset against Operation and Maintenance Expenses (O&M expenses) and General & Administrative Expenses (G&A expenses) resulting in a per book net operating income after taxes of \$1,660. Customer growth of \$22 was computed on the per book net operating income resulting in per book total income for return of \$1,682. Using total

income for return of \$1,682 and operating revenues of \$956,500, ORS computed a per book operating margin of 0.18%. The net effect of the accounting and pro forma adjustments increased total income for return from \$1,682 to \$8,765, and increased the operating margin from 0.18% to 1.43%. Hearing Exhibit 14, Corrected Audit Exhibit A, P. 5.

The following table indicates (1) Midlands' gross revenues for the test year after adjustments approved herein under the current rate schedule; (2) Midlands' operating expenses for the test year after accounting and pro forma adjustments and adjustments for known and measurable out-of test year occurrences approved herein; and (3) the operating margin under the presently approved schedule for the test year:

TABLE A

Before Increase As Adjusted

Operating Revenues	\$612,692
Operating Expenses	604,944
Net Operating Income/Loss	18,648
Add: Customer Growth	<u>117</u>
 TOTAL INCOME FOR RETURN	 <u><u>8,765</u></u>
 Operating Margin	 1.43%
(Interest Expense For Operating Margin)	0

8. Based on the need and requirement that Midlands upgrade certain of its wastewater treatment facilities pursuant to a Consent Order with DHEC, we find that Midlands has demonstrated a need for an increase in rates. While adjusted test year operations reveal an operating margin of 1.43%, Midlands requires an increase in rates in order to upgrade its facilities to comply with the Consent Order and to meet permitting limits.

9. When applied to as adjusted test year operations, the rates requested and proposed by Midlands result in an operating margin of 22.33% for Phase-I and 16.62% for Phase-II. Information concerning the effect of the proposed rates when applied to as adjusted test year operations of Midlands is found in ORS exhibits introduced during the hearing and the Company's Application, as amended. ORS witness Barnette calculated the rates proposed by Midlands for the Phase-I rate increase, would produce additional revenues of \$323,809 which result in an operating margin of 22.33%. Hearing Exhibit 15, Corrected Audit Exhibit A. We concur with the findings of ORS. We also calculate that the rates proposed by Midlands for the Phase-II rate increase would produce additional revenues of \$35,200 which results in an operating margin of 16.62% following implementation of Phase-II rates.

10. The Commission finds that the proposed increase as presented by Midlands is just and reasonable and will produce rates which are just and reasonable. Accordingly, the Commission approves the two phase increase in rates as proposed by Midlands. The evidence and adjustments for the herein approved increase are discussed in this section.

ADJUSTMENTS ASSOCIATED WITH PHASE-I OF INCREASE:

(A) Service Revenue Adjustment for Proposed Increase [Adjustment #40]

(1) Position of Midlands: Midlands proposes to adjust service revenues for the proposed increase on a net revenue base of \$316,238.

(2) Position of ORS: ORS' proposed service revenue adjustment amounts to \$323,809 as provided by the Water/Wastewater Department. See ORS Witness Barnette Testimony P. 16, ll. 21-22.

(3) Decision of Commission: The Commission finds ORS proposed service revenue adjustment of \$323,809 to be reasonable and adopts ORS' adjustment.

(B) Income Taxes [Adjustment #39]

(1) Position of Midlands: Midlands does not propose to adjust for Income Taxes associated with the As Adjusted Revenue.

(2) Position of ORS: ORS proposes to adjust for income taxes associated with the As Adjusted Revenue. This increase is in the amount of \$2,061. See ORS Witness Barnette Testimony, P. 16, ll. 19-22.

(3) Decision of Commission: The Commission agrees with ORS that the Income Taxes associated with the As Adjusted Revenue should be adjusted. The utility operations are the source of the tax liability and coverage for the tax liability should be included in the Company's rates. The Commission finds that the appropriate adjustment to Income Taxes based on the adjustments approved herein should be \$2,061.

(C) Gross Receipts Tax for the Proposed Increase [Adjustment #41]

(1) Position of Midlands: Midlands does not propose an increase related to the Gross Receipts Tax for the Proposed Increase.

(2) Position of ORS: ORS proposes to reflect the gross receipts taxes associated with the proposed increase. The gross receipts factor includes cost for administration, the Public Service Commission and the Office of Regulatory Staff. The ORS adjustment is computed using the Proposed Increase Revenue of \$323,809 multiplied by the gross receipts factor of \$0.007733226 resulting in an amount of \$2,504. See ORS Witness Barnette Testimony, P. 17, ll. 3-7; Audit Exhibit A-1, P. 4 of 5.

(3) Decision of Commission: The Commission believes the ORS adjustment for gross receipts tax is reasonable and consistent with the previous adjustments. Since the Commission has adopted and approved the two phase proposed increase in service revenue, it is appropriate to adjust the gross receipts tax in the amount of \$2,504.

(D) Uncollectibles associated with Proposed Increase (Phase I)[Adjustment #42]

(1) Position of Midlands: Midlands does not propose an adjustment to uncollectibles for the As Adjusted Revenue.

(2) Position of ORS: ORS proposes to adjust expenses for a 1.5% allowance for uncollectibles associated with the proposed increase. The 1.5% allowance is an industry standard and is more than Midlands' actual test year uncollectible rate of 1.35%. ORS' adjustment used the proposed increase revenues of \$323,809 multiplied by the 1.5% allowance factor, for a total adjustment of \$4,857. See ORS Witness Barnette Testimony, P. 17, ll. 8-12; Audit Exhibit A-1, P. 4 of 5.

(3) Decision of Commission: The Commission finds the 1.5% uncollectible rate proposed by ORS and recognized as the industry standard to be reasonable. The 1.5% factor requires an adjustment of \$4,857 for the proposed increase (Phase I).

(E) Income Taxes associated with Proposed Increase Revenues [Adjustment #43]

(1) Position of Midlands: Midlands proposes an adjustment of \$28,452 to adjust income taxes associated with the proposed increase revenue.

(2) Position of ORS: ORS proposes an adjustment of \$118,759 to adjust for income taxes associated with the Proposed Increase Revenue. See ORS Witness Barnette Testimony, P. 17, ll. 13-15 and Audit Exhibit A-3, P. 4 of 5.

(3) Decision of Commission: The Commission agrees that the Income Taxes associated with the As Adjusted Revenue should be adjusted. The utility operations are the source of the tax liability and coverage for the tax liability should be included in the Company's rates. The Commission finds that the appropriate adjustment to Income Taxes based on the adjustments approved herein should be \$118,759.

ADJUSTMENTS ASSOCIATED WITH PHASE-II OF THE INCREASE:

(A) Service Revenues [Adjustment #44]

(1) Position of Midlands: Midlands proposes to adjust the service revenue by a net revenue amount of \$35,150.

(2) Position of ORS: ORS proposes to adjust service revenues to reflect changes in revenues after construction. ORS' proposed an adjustment to service revenue in the amount of \$35,200. See ORS Witness Barnette Testimony, P. 17 ll. 16-18, Audit Exhibit A-1.

(3) Decision of Commission: The Commission agrees that the service revenues should be adjusted to reflect changes in revenues after construction. The Commission finds that the appropriate adjustment to service revenues after construction (Phase II) should be \$35,200.

(B) Depreciation Expense [Adjustment #45]

(1) Position of Midlands: Midlands proposes an adjustment of \$46,750 based on a 20 year service life period for the existing WWTFs.

(2) Position of ORS: ORS proposes to adjust depreciation expense for plant in service by \$34,062 using ORS recommended depreciation rates including plant upgrades proposed in Phase II. ORS reduced depreciation for expenses associated with Contributions in Aid of Construction. ORS also proposes to allocate certain plant in service to DSI and

BRUI. See ORS Witness Barnette Testimony, P. 17-18, Audit Exhibit A-1, P. 5 of 5. The Water/Wastewater department proposes basing depreciation expense on depreciation rates found in the Florida Public Service Commission Water and Wastewater System Regulatory Law as recommended by NARUC. ORS recommends that the existing Midlands' wastewater treatment facilities ("WWTF") cost be capitalized and depreciated over a 32-year average service life and also that any new WWTFs cost be capitalized over a 32-year average service life period. Hearing Exhibit 9, Morgan Direct Testimony, P. 5, ll. 12-23, Audit Exhibit A-1, P. 5 of 5.

(3) Decision of Commission: We find that ORS' adjustments are appropriate and adopt them as computed. We find ORS' recommended 32-year service life for existing plant is reasonable and sound. See Commission Order No. 96-44 (January 19, 1996), Docket No. 94-727-S Application of DSI for Approval of an Increase in Rates and Charges for Sewer Service and Docket No. 94-728-S – Application of BRUI for Approval of an Increase in Rates and Charges for Sewer Services. See the decision of the Commission for expense adjustment (DD) under Finding of Fact 6, infra.

(C) Chemical Expense [Adjustment #46]

(1) Position of Midlands: Midlands, in its application proposed to adjust chemical expenses by \$5,000. See ORS Witness Barnette Testimony, P. 18, Audit Exhibit A-1, P. 5 of 5.

(2) Position of ORS: ORS proposes to adjust O&M Expense – Chemical expenses to reflect the projected expense after construction. In the As Adjusted calculation, ORS proposed no adjustment in the booked balance of \$10,639. Therefore, the calculation to get to the after construction expense is \$10,639 less \$5,000 (per application) which equals an

adjustment of (\$5,639). See ORS Witness Barnette Testimony, P. 18, 4-8. Audit Exhibit A-1, P. 5 of 5.

(3) Decision of Commission: The Commission finds the ORS adjustment for chemical expenses is reasonable and consistent with the previous adjustments. The Commission adopts ORS' adjustment of (\$5,639) as the chemical expense adjustment following implementation of Phase-II of the increase.

(D) Property Taxes and Gross Receipts Tax [Adjustment #47]

(1) Position of Midlands: Midlands proposes a \$5,000 increase in taxes from during Construction to after construction.

(2) Position of ORS: ORS proposes to adjust Taxes Other Than Income to reflect an increase in property taxes and Gross Receipts tax in the After Construction Phase. This adjustment is based upon Midlands' estimated amount for taxes in the After Construction Phase. Gross Receipts taxes on the proposed increase would equal \$272. MUI proposes a \$5,000 increase in taxes from During Construction to After Construction. ORS proposes a change of \$6,904 from As Adjusted to After Construction Taxes Other Than Income.

(3) Decision of Commission: The Commission finds ORS' adjustment based upon Midlands estimated amount for taxes in the After Construction phase is reasonable and adopts ORS adjustments to reflect an increase in property taxes and gross receipt taxes in the amount of \$6,904.

(E) Utilities [Adjustment #48]

(1) Position of Midlands: Midlands proposes an After Construction amount for utilities expense in the amount of \$20,000.

(2) Position of ORS: ORS proposes to adjust O&M Expenses – Utilities expense to reflect the change in amount from the As Adjusted balance to the After Construction amount as proposed by MUI. This is an adjustment from per books of \$40,963 to \$60,000 per application or \$19,037.

(3) Decision of Commission: The Commission concurs with ORS' calculation of the adjustment for utilities expense after construction (Phase II) in the amount of \$19,037.

(F) Insurance Expense [Adjustment #49]

(1) Position of Midlands: Midlands proposes to increase insurance expense in Phase II in the amount of \$10,000.

(2) Position of ORS: ORS proposes to adjust O&M Expenses – Insurance expense to reflect the change in amount from the As Adjusted balance to the After Construction amount as proposed by Midlands. This is an adjustment from Per Books As Adjusted of \$73,699 to \$98,000 as proposed in the application or \$24,301.

(3) Decision of Commission: The Commission finds ORS' adjustments and manner in arriving at these adjustments to be reasonable. The Commission allows the ORS recommended adjustment to insurance expense in the amount of \$24,301 for after construction (Phase II).

(G) Interest Expense [Adjustment #50]

(1) Position of Midlands: Midlands' application for after construction operation includes interest of \$40,485.

(2) Position of ORS: ORS proposes to adjust Interest Expense from As Adjusted to the After Construction amount as proposed by Midlands in its application. The interest expense includes interest on customer deposits and interest expense on the new plant. This

adjustment is calculated as follows: Interest After Construction per application of \$40,485 less Interest on Customer Deposits As Adjusted of \$2,051 equals the adjustment of \$34,439. ORS' calculation reflects total interest per application. See ORS Witness Barnette Testimony, P. 19, ll. 3-7, Audit Exhibit A-1, P. 5 of 5.

(3) Decision of Commission: The Commission finds that ORS' adjustments and manner in arriving at these adjustments is reasonable. The Commission allows ORS' interest in the amount of \$38,434 interest expense after construction (Phase II).

(H) Income Taxes [Adjustment #51]

(1) Position of Midlands: Midlands proposes to increase income taxes in the amount of \$6,238 to adjust income taxes with the after construction proposed increase in the amount of (\$34,439).

(2) Position of ORS: ORS proposes to adjust income taxes associated with the After Construction Proposed Increase in the amount of (\$34,439). See ORS Witness Barnette Testimony, P. 19, ll. 8-10. See Audit Exhibit A-3, Computation of Income Taxes for details.

(3) Decision of Commission: Although the Commission is aware that ORS was unable to verify, during the audit, the amounts shown in the After Construction column as provided in the application since the plant has not been constructed and the related expenses realized, the Commission agrees with both Midlands and ORS that the income taxes associated with the proposed increase should be adopted.

7. The Commission finds that an operating margin of 22.33% in Phase-I and 16.62% in Phase-II is just and reasonable and results in just and reasonable rates to charge for the services offered by Midlands.

8. The level of operating revenue required for Midlands to have an opportunity to earn a 22.33% operating margin under Phase-I rates is found to be \$936,501. The level of operating revenues required for Midlands to have an opportunity to earn a 16.62% operating margin under Phase-II rates is found to be \$971,701.

The following table indicates (1) Midlands' gross revenues for the test year after adjustments approved herein, under the proposed Phase-I rate schedule; (2) Midlands' operating expenses for the test year after accounting and pro forma adjustments and adjustments for known and measurable out-of-test year occurrences approved herein; and (3) the operating margin under the proposed Phase-I rate schedule:

TABLE B

After Phase-I Increase

Operating Revenues	\$ 936,501
Operating Expenses	\$ 730,164
Net Operating Income/Loss	\$ 206,337
Add: Customer Growth	<u>2,778</u>
 TOTAL INCOME FOR RETURN	 <u>209,115</u>
 Operating Margin	 22.33%
(Interest Expense For Operating Margin)	<u>\$ 0</u>

In order to meet the income requirement for the opportunity to earn an operating margin of 22.33%, Midlands will require additional revenues of 323,803. This amount of additional revenues represents Midlands proposed Phase-I increase.

The need for the Phase-II increase has been justified by Midlands. We hold that ORS must conduct an audit of such plant expenditures and report back to this Commission, prior to the Phase-II rate increase going into effect. This will be discussed

further below, along with other conditions that must be met before the Company may put the Phase-II increase into effect.

Additional revenues of \$35,200 are appropriate for Phase-II of the increase, for total operating revenues of \$971,701. Total operating expenses for Phase-II are \$774,390. We hold that all accounting adjustments from Phase-I will carry over into Phase-II. Total operating margin for Phase-II is 16.62%, considering interest expense of \$38, 434. This may be calculated as follows:

TABLE C

After Phase-II Increase

Operating Revenues	\$ 971,701
Operating Expenses	774,390
Net Operating Income/Loss	197,311
Add: Customer Growth	<u>2,656</u>
 TOTAL INCOME FOR RETURN	 <u>199,967</u>
 Operating Margin	 16.62%
Interest Expense for Operating Margin	<u>\$ 38,434</u>

11. The Commission finds the increase in tap fees should be approved.

By its Application, Midlands requested to increase its customer tap fees from \$250.00 per SFE to \$500.00 per SFE, an increase of 100%. Midlands asserts that tap fees have not increased since the Parnell family has owned Midlands and that the increase in tap fee is necessary to recapture the plant investment.

ORS' position is that Midlands originally did not provide any cost justification for the proposed increase in customer tap fees and had not included in its application an exhibit setting forth all cost criteria justifying the tap fee. ORS initially asserted that

Midlands had failed to comply with 26 S.C. Code Regs. 103-512.4.A.0 which requires that proper cost justification include labor costs, material costs and miscellaneous costs. At the rate increase hearing, ORS witness Hipp testified that ORS had subsequently received information from Midlands justifying the increase in tap fees and that she was satisfied with Midlands' justification.

The Commission finds that Midlands has complied with Commission regulations and has provided adequate information justifying the increase in tap fees. Tap fees are booked as Contributions in Aid of Construction ("CIAC") and are included as a deduction from rate base. The Commission approves the increase in tap fees, but finds that the hearing record does not support an increase in plant expansion and modification fees.

12. The current performance bond of Midlands is insufficient and does not meet the requirements of S.C. Code Ann. Section 58-5-720 (Supp. 2004).

S.C. Code Ann. Section 58-5-720 (Supp. 2004) was amended in May 2000 and increased the required amounts of performance bonds to a minimum of \$100,000 and a maximum of \$350,000. Thereafter, the Commission's regulations were amended to provide for determining the amount of bond required by each utility. 26 S.C. Code Regs. 103-512.3.1 (Supp. 2004) was amended to provide that the amount of the bond should be based on the total amount of certain expense categories.

ORS witness Hipp provided testimony concerning the performance bond filed by Midlands. According to witness Hipp, Midlands has on file a performance bond with a face amount of \$50,000. The performance bond is secured by a personal financial statement of Mr. Keith Parnell, President of Midlands. Witness Hipp opined that the

performance bond is insufficient because it does not meet the statutory amount required for the performance bond. Further, Ms. Hipp testified that the surety filed to support the performance bond is insufficient because (1) the amount of the surety does not comply with the requirement of 26 S.C. Code Regs. 103-512.3.1 (Supp. 2004); (2) the financial statement does not accurately depict the net worth of the surety as required by 26 S.C. Code Regs. 103-512.3.2 and 103-512.3.3; (3) the real estate indicated on the financial statement is in the name of another person and there is no documentation indicating authorization to pledge the real estate as part of the surety; and (4) the same financial statements and surety are used to secure performance bonds of Midlands' sister companies BRUI and DSI. On March 17, 2005, Midlands filed a late filed exhibit consisting of an affidavit of Mary G. Parnell representing that Lot 25, Section B, Rice Lane Plat Book 23, P. 78, Edisto Beach, Colleton County, South Carolina may be shown for surety and bond as necessary for DSI, BRUI, and Midlands. Mary Parnell in the affidavit represents that the lot is not now mortgaged, pledged or otherwise hypothecated. No appraisal identifying the fair market value of this property has been provided to the Commission.

Witness Hipp calculated that an appropriate bond for Midlands based upon the criteria contained in 26 S.C. Code Regs. 103-512.3.1, would be \$350,000. ORS Witness Hipp Direct Testimony Pp. Pp. 6-8 and Hearing Exhibit 13, Exhibit DMH-2.

DSI witness Parnell testified that Midlands had complied with the Commission's requirements concerning the performance bond. Keith G. Parnell Rebuttal Testimony, P. 2. Upon review of this issue, however, we find that Midlands' bond does not meet the statutory requirements of S.C. Code Ann. Section 58-5-720 (Supp. 2004). The statute

requires a minimum bond of \$100,000 up to a maximum of \$350,000. The requirement of the performance bond is to protect the public and to insure that the utility provides adequate and proper service. Accordingly, we hold that Midlands must provide a \$350,000 performance bond. Midlands must provide the \$350,000 performance bond and be in compliance with the bonding requirements of S.C. Code Ann. 58-5-720 (Supp. 2004) and 26 S.C. Code Regs. 103-512.3 prior to implementing Phase-I of the rate increase. The Commission will review bonding requirements if a merger of the three companies occurs.

13. The Commission finds that Midlands should review all customer deposit accounts and, if the account is found not to meet the deposit retention criteria indicated in 26 S.C. Code Regs. 103-531.5, then each deposit should be adjusted/refunded with the proper accrued interest to each customer. Midlands shall also review all deposit customer accounts and adjust/refund proper accrued interest for those accounts where it is acceptable to continue to retain the deposit.

ORS recommended that Midlands review its customer deposits and make adjustments to comply with Commission regulations and Commission Orders. ORS asserted that the Commission, under Order 2003-593 dated October 2, 2003, adjusted the interest rate for customer deposits from 8% to 3.5% effective January 1, 2004. Interest for customers in which Midlands retained deposits prior to December 31, 2003, should be due and payable at 8%. According to the books and records of Midlands, the customer deposit account had a balance of \$56,587 as of December 31, 2003. ORS recommended that Midlands should review all customer deposit accounts by the close of fiscal year 2003-2005 and, if deposits for any customers are found not to meet the deposit retention

criteria indicated in S.C. Code Regs. 103-531.5, then the deposits should be adjusted/refunded with the proper accrued interest to the respective customers. Midlands shall also review all deposit customer accounts and adjust/refund proper accrued interest for those accounts where it is acceptable to continue to retain the deposit. Accrued interest on customer deposits is payable to each customer at least every two years and at the time the deposit is returned. ORS asserted that due to the length of time that Midlands has retained some customer deposits, Midlands should be required to adjust/refund proper interest at both the 8% and 3.5% interest rate.

The Commission finds that Midlands shall comply with the Commission's Order 2003-593 and adjust the interest rate for customer deposits from 8% to 3.5% effective January 1, 2004. Midlands shall calculate interest at the rate of 8% for those customer deposits which Midlands has retained prior to December 31, 2003. Midlands concurs with the recommendations of the ORS, and Midlands shall review all customer deposits and adjust/refund proper accrued interest to all accounts. If the account does not meet the deposit retention criteria, then Midlands shall adjust/refund each deposit plus proper accrued interest to the customer, Midlands shall also adjust/refund proper accrued interest for those accounts where it is acceptable to continue to retain the deposit. Midlands shall refund accrued interest on customer deposits at least every two years and at the time the deposit is returned.¹⁶ The Commission finds that Midlands should maintain its books and records in accordance with the NARUC Uniform System of Accounts, as adopted by this Commission.

Midlands witness Parnell testified that DSI is working to maintain its books and records under the NARUC Uniform System of Accounts and is in the process of making

changes in order to bring Midlands' books and records into compliance with the NARUC Uniform System of Accounts.. The Commission's rules and regulations require sewerage utilities to use the NARUC Uniform System of Accounts. Keeping books and records in compliance with NARUC's Uniform System of Accounts will not only mean compliance with 26 S.C. Code Regs. 103-517, but will also make regulatory audits easier and less burdensome. ORS requested that Midlands be required to maintain its books and records under NARUC's Uniform System of Accounts. We agree that Midlands should be maintaining its books and records under the NARUC Uniform System of Accounts as required by the Commission's regulations, and we finds that Midlands should be in compliance with this requirement by the end of Phase-I.

After considering the Midlands' testimony in this case, it appears that Midlands personnel lack understanding of our Rules and Regulations, for whatever reason. We encourage Midlands to study the Commission's Rules and Regulations more carefully, and attempt to gain a better understanding of them. Further, we urge Midlands to seek help from personnel at the Office of Regulatory Staff when appropriate in this endeavor.

CONCLUSIONS OF LAW

Based upon the Findings of Fact as contained herein and the record of this proceeding,

the Commission makes the following Conclusions of Law:

1. Midlands is a public utility as defined in S.C. Code Ann. § 58-5-10(3) (Supp. 2004)

and as such is subject to the jurisdiction of this Commission.

2. The appropriate test year on which to set rates for Midlands is the twelve month period ending June 30, 2004.

3. Based on the information provided by the parties, the Commission concludes the appropriate rate setting methodology to use as a guide in determining the lawfulness of Midlands proposed rates and for the fixing of just and reasonable rates is operating margin.

4. For the test year of June 30, 2004, the appropriate operating revenues, under present rates and as adjusted in this Order, are \$612,692, and the appropriate operating expenses, under present rates and as adjusted in this Order, are \$604,044.

5. We conclude that Midlands has demonstrated a need for the here-in approved a rate increase. We further conclude that Midlands has demonstrated the need for the two-phase increase in rates proposed in the application. Midlands has provided justification for an increase beyond the Phase-I rates as additional known and measurable expenses have been identified. After Phase-I of the rates, Midlands should have an operating margin of 22.33%. We conclude that an operating margin of 22.33% is fair and reasonable and results in rates which are just and reasonable. Likewise, we believe that an operating margin of 16.62% is fair and reasonable, and results in rates which are fair and reasonable for Phase-II of the rate increase.

6. In order for Midlands to have the opportunity to earn the 22.33% operating margin for Phase-I and 16.62% for Phase-II found fair and reasonable herein, Midlands must be allowed additional revenues of \$323,809 and \$35,200 respectively.

7. The proposed increase in the tap fee is approved; however the requested increase in plant expansion and modification is not approved.

8. The rates as set forth in the attached Appendix A are approved for use by Midlands and are designed to be just and reasonable without undue discrimination and are also designed to meet the revenue requirements of Midlands.

9. Based upon the requirements of S.C. Code Ann. Section 58-5-720 (Supp. 2004) and of 26 S.C. Code Regs. 103-512.3.1 (Supp. 2004), Midlands shall post a performance bond of \$350,000 before implementation Phase-I of the rate increase. The performance bond shall be in a form as allowed by S.C. Code Ann. Section 58-5-720 and 26 S.C. Code Regs. 103-512.3 through 103-512.3.3 (Supp. 2004).

IT IS THEREFORE ORDERED THAT:

1. Midlands is granted an operating margin for its sewer service of 22.33% for Phase-I and 16.62% for Phase-II.

2. The schedule of rates and charges attached hereto in Appendix A are hereby approved for Phase-I of the rate increase for service rendered on or after the date of this Order and after posting the bond required in this Order. Further, the schedule is deemed filed with the Commission pursuant to S.C. Code Ann. Section 58-5-240 (Supp. 2004). Prior to the Company implementing Phase-II of the rate increase, the Company shall undergo an audit by the Office of Regulatory Staff. Further, prior to entering Phase-II, Midlands shall be in compliance with all SCDHEC regulations. In addition, prior to implementing Phase-II, the Company must be maintaining its books and records according to the NARUC System of Accounts. The Company must certify its compliance with all of these requirements before entering Phase-II of the rate increase.

Further, ORS must certify to this Commission that it has performed the required audit, and the results of that audit. Should the audit reveal non-compliance with Commission directives in this matter, the Company may not implement Phase-II of the rate increase until further Order of the Commission. In addition, DHEC must certify compliance of the Company with all of its requirements to the Commission. We cannot sufficiently stress the necessity for compliance with all directives of this Commission before implementation of Phase-II of the rate increase.

3. Should the schedules containing rates for Phase-I of the rate increase approved herein not be placed into effect within three months of this Order, Midlands shall require written approval from this Commission to place the rates into effect.

4. As discussed above, Midlands shall maintain its books and records in accordance with the NARUC Uniform System of Accounts as adopted by this Commission by the end of Phase-I.

5. Also, as discussed above, pursuant to and consistent with S.C. Code Ann. Section 58-5-720 and 26 S.C. Code Regs. 103-512.3 through 103-512.3.3 (Supp. 2004), Midlands shall post a performance bond with a face value of \$350,000 prior to implementing Phase-I of the rate increase.

6. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

Randy Mitchell, Chairman

ATTEST:

G. O'Neal Hamilton, Vice Chairman